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2005 (in millions of euros)	Q1	Q2	Q3	Q4	Total
Revenues	2,180	2,647	2,871	3,521	11,219
Cost of sales	(1,343)	(1,660)	(1,840)	(2,242)	(7,085)
<b>Gross profit</b>	<b>837</b>	<b>987</b>	<b>1,031</b>	<b>1,279</b>	<b>4,134</b>
Administrative and selling expenses	(454)	(468)	(453)	(440)	(1,815)
Research and development costs	(306)	(305)	(335)	(352)	(1,298)
<b>Income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities</b>	<b>77</b>	<b>214</b>	<b>243</b>	<b>487</b>	<b>1,021</b>
Restructuring costs	(10)	(23)	1	(47)	(79)
Gain/(loss) on disposal of consolidated shares	-	-	129	-	129
<b>Income (loss) from operating activities</b>	<b>67</b>	<b>191</b>	<b>373</b>	<b>440</b>	<b>1,071</b>
Financial interest on gross financial debt	(53)	(55)	(57)	(50)	(215)
Financial interest on cash and cash equivalents	24	36	32	30	122
Finance costs	(29)	(19)	(25)	(20)	(93)
Other financial income (loss)	48	26	(41)	10	43
Share in net income (losses) of equity affiliates	(1)	(22)	9	-	(14)
<b>Income before tax and discontinued operations</b>	<b>85</b>	<b>176</b>	<b>316</b>	<b>430</b>	<b>1,007</b>
Income tax expense	49	28	(108)	(115)	(146)
<b>Income (loss) from continuing operations</b>	<b>134</b>	<b>204</b>	<b>208</b>	<b>315</b>	<b>861</b>
Income (loss) from discontinued operations	2	4	64	40	110
<b>NET INCOME (LOSS)</b>	<b>136</b>	<b>208</b>	<b>272</b>	<b>355</b>	<b>971</b>
Attributable to:					
- Equity holders of the parent	124	196	266	344	930
- Minority interests	12	12	6	11	41
<b>Net income (loss) attributable to the equity holders of the parent per share (in euros)</b>					
- Basic earnings per share	0.09	0.14	0.19	0.25	0.68
- Diluted earnings per share	0.09	0.14	0.19	0.25	0.68
<b>Net income (loss) (before discontinued operations) attributable to the equity holders of the parent per share (in euros)</b>					
- Basic earnings per share	0.09	0.14	0.14	0.22	0.60
- Diluted earnings per share	0.09	0.14	0.14	0.22	0.60
<b>Net income (loss) of discontinued operations per share (in euros)</b>					
- Basic earnings per share	-	-	0.05	0.03	0.08
- Diluted earnings per share	-	-	0.05	0.03	0.08

## Note 38 – Summary of differences between accounting principles followed by Alcatel-Lucent and U.S. GAAP

Alcatel-Lucent's consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU (see Note 1) which differ in certain respects from generally accepted accounting principles in the United States ("U.S. GAAP"). Differences that existed between generally accepted accounting principles in France ("French GAAP"), which was used before IFRS, will continue to exist in certain areas as a result of the transitional provisions applied under IFRS 1 even though an IFRS accounting policy may be the same, or similar, to that applied under U.S. GAAP.

Those differences which have a significant effect on the Group's net result and equity for the financial year are as follows:

### (a) Differences in accounting for business combinations

**Adoption of French "Pooling of Interests" accounting method for stock-for-stock business combinations under French GAAP that were not restated in the opening IFRS balance sheet (as of January 1, 2004)**

From January 1, 1999, in connection with the change in French accounting principles, Alcatel accounted for its acquisition of DSC Communications Corporation ("DSC") under the French pooling of interests accounting method: assets and liabilities of DSC Communications Corporation were accounted for on a carryover basis at the acquisition date, adjusted to Alcatel's accounting method. The difference resulting from the application of the pooling of interests accounting method remained in shareholders' equity.

The two stock-for-stock acquisitions made during the first half of 2000, Genesys Telecommunications Laboratories ("Genesys") and Newbridge Networks Corporation ("Newbridge"), the stock-for-stock acquisition of Kymata made during the second half of 2001, the stock-for-stock acquisition of Astral Point and Telera made during 2002 and the stock-for-stock acquisition of TiMetra made during 2003 have been accounted for using the pooling of interests accounting method under French GAAP.

Under IFRS, these business combinations have not been restated to conform with IFRS 3 *Business combinations* ("IFRS 3") requirements, as permitted by the exemption authorized by IFRS 1 § 13(a) that we elected.

Under U.S. GAAP, the DSC, Genesys, Newbridge, Kymata, Astral Point and Telera acquisitions have been recorded under the purchase accounting method. TiMetra being a development stage-company when acquired, which did not meet the definition of a business as defined by EITF Issue No. 98-3 *Determining Whether a Non-Monetary Transaction Involves Receipt of Productive Assets or of a Business*, the difference between the fair value of net assets acquired and the purchase price was accounted for in operating expenses.

The purchase prices were mainly allocated to acquired technology, in-process research and development, fair value of investments, deferred compensation and deferred tax liabilities resulting in goodwill of:

<i>(in millions)</i>	Date of acquisition	Currency	Goodwill
DSC	1998	US\$	2,613
Genesys	2000	US\$	1,471
Newbridge	2000	CAD	6,968
Kymata	2001	GBP	57
Astral Point	2002	US\$	138
Telera	2002	US\$	47
TiMetra	2003	US\$	114 <sup>(1)</sup>

<sup>(1)</sup> As TiMetra did not meet the definition of a business as defined by EITF Issue No. 98-3 *Determining Whether a Non-Monetary Transaction Involves Receipt of Productive Assets or of a Business*, an amount of US\$114 million, representing the excess of the purchase price over the fair value of all identifiable assets acquired and liabilities assumed, was accounted for directly in the income statement as a loss. The fair value of the identifiable assets acquired was based upon an appraisal made by an external expert.

As part of the changeover to IFRS on and after January 1, 2005, the French "pooling of interest" method of accounting for business combinations occurring in 2004 has been abandoned on and after January 1, 2004 by the Group (see Note 1c).

***Intangible assets and impairment***

In connection with the acquisitions described above, the Group allocated part of the purchase prices to acquired technologies. The amounts recorded at the acquisition dates were: US\$256 million for DSC, US\$59 million for Genesys, CAD694 million for Newbridge, GBP10 million for Kymata, US\$8 million for Astral Point, US\$27 million for Telera and US\$40 million for TiMetra. Those intangible assets are amortized over their estimated useful life (three to seven years) and are tested for impairment in compliance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144").

***Allocation of the purchase price to in-process research and development projects related to business combinations accounted for using the french "pooling of interests" method and not restated in the IFRS opening balance sheet*****DSC**

In connection with the acquisition of DSC, the Group allocated US\$1,096 million of the purchase price to in-process research and development projects. At the acquisition date, DSC was conducting design, development, engineering and testing activities associated with the completion of hundreds of projects aimed at developing next-generation technologies that were expected to address emerging market demands for the telecommunication equipment market. The allocation of US\$1,096 million of the purchase price to these in-process research and development projects represented their estimated fair values. More specifically, the development, engineering and testing activities associated with the following technologies were allocated as portions of the purchase price: Access (US\$600 million), Switching (US\$400 million), and Transmission (US\$96 million).

**Newbridge**

In connection with the acquisition of Newbridge, the Group allocated US\$750 million of the purchase price to in-process research and development projects.

At the acquisition date, Newbridge was conducting design, development, engineering and testing activities associated with the completion of numerous projects aimed at developing next-generation technologies that were expected to address emerging market demands for the telecommunication equipment market. The allocation of US\$750 million of the purchase price to these in-process research and development projects represented their estimated fair value. More specifically, the development, engineering and testing activities associated with the following technologies were allocated portions of the purchase price: Switching and Routing (US\$505 million) and Access (US\$245 million).

**Genesys**

At the acquisition date, Genesys was conducting design, development, engineering and testing activities associated with the completion of several projects related to Genesys release 6. The allocation of US\$100 million of the purchase price to the in-process research and development projects represented their estimated fair values.

**TiMetra**

At the acquisition date, TiMetra was developing routers to handle data traffic at what is known as the network edge, the part of the data network that links offices, homes and other buildings to the long distance "core" network. In June 2003, TiMetra introduced its first product, for next generation carrier networks, designed to fit multiple applications. The allocation of US\$5.5 million of the purchase price to the in-process research and development projects represented their estimated fair values.

Approximately US\$42 million had been spent on research and development projects as of the valuation date. Costs to complete the projects were estimated at approximately US\$9 million over 24 months following the acquisition. Management estimated that the aforementioned projects were in various stages of development and were approximately 80% complete, in the aggregate, based on development costs.

Estimated total revenues from the acquired in-process technology were expected at the time of the acquisition to peak in 2006 and 2007 and steadily decline thereafter as other new products and technologies were expected to be introduced by Alcatel-Lucent.

The estimated costs of good sold as well as operating expenses as a percentage of revenues for TiMetra were expected to be materially consistent with historical levels, primarily due to the extremely competitive nature of the industry and the need to continue to spend heavily on research and development.

A discount rate of 35% was used for determining the value of the in-process research and development. This rate is higher than the implied weighted average cost of capital for the acquisition due to inherent uncertainties surrounding the successful development of the purchased in-process technology, the useful life of such technology, the profitability levels of such technology, and the uncertainty of technological advances that were unknown at that time.

***Allocation of the purchase price to in-process research and development projects and other differences between IFRS and U.S. GAAP related to business combinations accounted for using the purchase method***

As part of the changeover to IFRS on and after January 1, 2005, the French "pooling of interest" method of accounting for business combinations occurring in 2004 has been abandoned on and after January 1, 2004 by the Group. All business combinations from January 1, 2004 onwards are accounted for using the purchase method.

Development expenditures that relate to an in-process research or development ("IPR&D") project acquired in a business combination is recognized as an intangible asset separate from goodwill under IFRS and U.S. GAAP.

Under U.S. GAAP (FASB Interpretation No. 4 *Applicability of FASB Statement No. 2 to Business Combinations Accounted For by the Purchase Method, an Interpretation of FASB Statement No. 2*), at the date the combination is consummated, all costs assigned to activities to be used in research and development are charged to expense unless the assets have alternative future uses. Therefore IPR&D identified in a business combination and accounted for as intangible assets apart from goodwill is fully written-off once the business combination is consummated.

On the other hand, under IFRS, expenditures related to IPR&D accounted for as an asset in a business combination are considered indefinite-lived until the completion or abandonment of the associated research and development efforts, at which point the useful life of this asset will be determined and the amortization will begin or the impairment booked.

The main IPR&D concerned are related to the following business combinations: Spatial Wireless in 2004, Native Networks in 2005 and Lucent Technologies and Nortel Networks in 2006.

#### **Spatial**

At the acquisition time, Spatial Wireless was developing a UMTS («Universal Mobile Telecommunications System») project qualified as in-process research and development project. This UMTS project, represents a major engineering effort to integrate UMTS and support for Wi-Fi handset access into the Alcatel's wireless Softswitch technology. The allocation of the purchase price to the in-process research and development projects was estimated at US\$10 million at the end of 2004 and subsequently valued at US\$14.5 million in 2005 during the allocation period.

Approximately US\$4 million had been spent since June 2003 on this in-process research and development project as of the acquisition date. Management estimated that the aforementioned project was approximately 80% complete, therefore, costs to complete the project were estimated at approximately US\$1 million over 5 months following the acquisition.

Estimated total revenues from the acquired in-process technology were expected at the acquisition date to peak in 2006 to 2010 and steadily decline thereafter as other new products and technologies were expected to be introduced by Alcatel-Lucent.

The estimated costs of good sold as well as operating expenses as a percentage of revenues for Spatial were expected to be materially consistent with historical levels, primarily due to the extremely competitive nature of the industry and the need to continue to spend heavily on research and development.

A discount rate of 30% was used for determining the value of the in-process research and development. This rate is higher than the implied weighted average cost of capital for the acquisition due to inherent uncertainties surrounding the successful development of the purchased in-process technology, the lifetime of such technology, the profitability levels of such technology, and the likelihood of technological evolutions unknown at that time.

#### **Lucent Technologies**

There are differences between IFRS and U.S. GAAP in determining the fair value of shares used as consideration in a business combination. Under IFRS, the fair value is measured as of the date of the exchange – the date on which the acquirer obtains control over the acquiree's net assets and operations. Under U.S. GAAP according to EITF Issue No. 99-12 *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, the fair value is measured over a reasonable period of time before and after the parties reach an agreement on the purchase price and the proposed transaction is announced. As a result, there are differences in the fair value of the ADR's, warrants and share-based awards issued in connection with the acquisition of Lucent. In addition, under IFRS, the fair value of debt conversion features is also considered as part of the purchase price as these features need to be bifurcated from the host security and recognized in equity.

Attached is an analysis of the purchase price of Lucent under IFRS and U.S. GAAP and the components to which the differences were allocated to.

#### **IFRS – U.S. GAAP Reconciliations (in millions of US\$)**

<b>Differences due to different measurement date:</b>	<b>IFRS</b>	<b>U.S. GAAP</b>	<b>Difference</b>
ADRs	11,758	13,927	2,169
Warrants	46	125	79
Share-based awards	175	291	116
<b>Subtotal</b>	<b>11,979</b>	<b>14,343</b>	<b>2,364</b>
Fair value of debt conversion feature	1,005	-	(1,005)
Transaction costs	53	53	-
<b>Total consideration</b>	<b>13,037</b>	<b>14,396</b>	<b>1,359</b>

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Differences allocated to:	Pre-tax	Tax	After tax
In process research and development <sup>(1)</sup>	-	226	226
Debt conversion features <sup>(2)</sup>	(1,005)	391	(614)
Asset ceiling <sup>(3)</sup>	2,286	-	2,286
Goodwill	(607)	-	(607)
Other	68	-	68
<b>TOTAL</b>	<b>742</b>	<b>617</b>	<b>1,359</b>

(1) Under U.S. GAAP, according to EITF Issue No. 96-7, Accounting the Deferred Taxes on In Process Research and Development Acquired in a Purchase Business Combination, no deferred taxes have been provided on IPR&D.

(2) Refer to Note 38i.

(3) Refer to Note 38f.

A detailed presentation of the purchase price allocation of Lucent's business combination under U.S. GAAP is presented in Note 41 (1) below.

The allocation of the in process research and development (IPR&D) by activities is as follows:  
(in millions of currencies)

	Fair values	
	US\$	€
Bell Laboratories	381	288
Mobility Access Solutions	97	73
Multimedia Network Solutions	97	74
Application Solutions	6	5
<b>TOTAL</b>	<b>581</b>	<b>440</b>

At the acquisition date, Lucent was conducting design, development, engineering and testing activities associated with the completion of numerous projects aimed at developing next-generation technologies for the telecommunication equipment market. The nature of the efforts to develop these technologies into commercially viable products consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technologies can meet market expectations, including functionality and technical requirements.

The Group's methodology used to allocate the purchase price to IPR&D is determined through established valuation techniques. The income approach was the primary valuation method employed, which discounts expected future cash flows related to the projects to present value. The discount rates used in the present value calculations are typically based on a weighted-average cost of capital analysis, venture capital surveys and other sources where appropriate. Adjustments were made to reflect the inherent risk of the developmental assets. The cost approach also was employed in selective cases of IPR&D, which entails estimating the cost to re-create the asset. We consider the pricing models related to the acquisition to be standard within the telecommunications industry.

The key assumptions employed in both approaches consist primarily of an expected completion date for the in-process projects; estimated costs to complete the projects; revenue and expense projections; and discount rates based on the risks associated with the development lifecycle of the in-process technology acquired. We cannot give assurances that the underlying assumptions used to estimate expected project revenues, development costs or profitability, or the events associated with such projects, as described below, will take place as estimated.

The acquisition of Lucent Technologies resulted in the allocation of US\$581 million of the purchase price to IPR&D. IPR&D was expensed under U.S. GAAP upon acquisition because no future alternative uses exist. Under IFRS, out of the \$581 million, an impairment charge of US\$93 million was accounted for as restructuring costs in December 2006 in connection with the discontinuance of certain product lines. The development of these technologies remains a significant risk due to the remaining efforts to achieve technological feasibility, rapidly changing customer markets, uncertain standards for new products, and significant competitive threats. Failure to bring these products to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets and could have a material adverse impact on our business and operating results.

A brief description of the subject IPR&D technology by business unit follows.

**Bell Labs** – The IPR&D efforts of Bell Laboratories ("Bell Labs") were valued at the estimated cost to recreate the assets at time of the acquisition. The projects represent short-term and long-term applied research pursuits in broad array of technological disciplines across Bell Labs' organizational groups. Projects with expected commercial application include development of:

- wireless network modeling;
- WiMax technology;
- voice-over-IP technologies;
- CDMA security;
- nanostructure devices;
- converged data-optical networks;
- quantum computing;
- 4G technology evolution.

Approximately US\$320 million was incurred on in-process R&D projects as of the acquisition date. Expected completion dates range from 6 months to five years. The acquired in-process R&D excludes many basic research projects ongoing at Bell Labs due to the early stage of development and lack of reasonably reliable estimates regarding future economics.

**Mobility Access Solutions** – The major programs under development represents a combined development effort by the CDMA and UMTS product groups to upgrade core platform technologies, which are expected to facilitate the rollout of sophisticated IP-based service portfolios utilizing the IMS architecture. Approximately US\$30 million had been spent on the R&D projects as of the acquisition date. Costs to complete the projects were estimated at approximately \$52 million over the twelve to eighteen months following the acquisition. Discount rates applied to the projected cash flows were 16% to 20%.

**Multimedia Networks Solutions** – The major programs involved upgrading optical technologies and developing next-generation data networking products. Over \$60 million had been spent on the R&D projects as of the acquisition date. Costs to complete the projects were estimated at approximately \$100 million over the twelve to twenty-four months following the acquisition. The Application Solutions IPR&D cash flows were discounted at 15% to 22%.

**Application Solutions** – Development projects that qualified as In-Process R&D included several projects within the unit's subscriber payment and data management solutions for mobile operators. Approximately US\$1 million had been spent on the R&D projects as of the acquisition date. Costs to complete the projects were estimated at approximately \$7 million over the twelve to eighteen months following the acquisition. The Application Solutions In-Process R&D cash flows were discounted at 20%.

#### **Nortel Networks**

Nortel has spent over US\$1.0 billion in the past five years on the development of the UMTS technology assets. The technology is based on current standards and architectures and is designed to allow for future enhancements. Royalty rate data was reviewed for contemporary transactions in the Telecommunications Transmission Technology market and Wireless-related Protocol market. The relevant range of royalty rate was 4.0% to 6.0%.

For the analysis performed a royalty rate of 6.0% was considered appropriate to reflect the specific characteristics of the acquired UMTS technology. It should be noted that certain of the comparable transactions reviewed involved restricted licenses arrangements (limited geography, markets, etc.) that would underestimate true ownership value. Additionally, both Alcatel and Nortel management considered the Nortel UMTS technology as more mature and superior to the existing Alcatel/Lucent solution. The majority of the UMTS technology platform going forward at Alcatel-Lucent will be comprised of Nortel UMTS assets.

The acquired UMTS developed technology was expected to contribute meaningfully to revenue generation for approximately seven years. The technology may contribute to the forthcoming Long-Term Evolution (4G) products beyond seven years, but it was unclear at the valuation date what role, if any, the acquired assets will play. The resulting cash flows were discounted to present value using a rate of 18.0% based on the UMTS technology's relative risk profile and position in its technology cycle. The present value associated with UMTS technology assets (including IPR&D) was €127 million.

In order to allocate this aggregate value to developed technology and IPR&D, the expected contribution to cash flows for the IPR&D was estimated and used as a factor for allocating its share of the total UMTS value. The remaining value was ascribed to the acquired developed technology and know how. The contribution of IPR&D was estimated based on the relative R&D costs incurred on the identified projects to the total R&D spent on the overall UMTS platform while in development at Nortel. UA 5.0 and UA 6.0 UMTS projects were identified as in-process at the valuation date. Nortel has spent approximately US\$130 million to date on the current R&D projects. The UA 5.0 and UA6.0 IPR&D projects have incurred US\$24.4 million and US\$0.2 million in development expenses, respectively, in 2005. Expenses incurred in 2006 were US\$102.7 million and US\$2.1 million respectively.

UMTS development effort over the last five years can be characterized by a period of three years of development of base UMTS technology, followed by two years of higher value, differentiating product technology (including UA 5.0 and UA 6.0 technologies). As such UA 5.0 and UA 6.0 development expenses were value-adjusted to reflect their higher contribution to the overall technology platform than the base technology components. The combined value-adjusted R&D spend as of the valuation date was estimated at approximately US\$188 million. Given an estimate of US\$1.0 billion incurred on the UMTS technology platform since its inception, the IPR&D represented 18.8% of the total spend. IPR&D has therefore been valued at US\$30.5 million (€24 million).

**Hedge of foreign currency risk in a business combination.****Nortel Networks**

Under U.S. GAAP, it is not authorized to get hedge accounting in a hedge of foreign exchange risk related to a business combination. There is no such requirement under IFRS and IAS 39-AG 98 stipulates that a firm commitment to acquire a business in a business combination can be considered as a hedge item if related to foreign exchange risk. Acquisition price of Nortel's UMTS technology assets acquired is therefore different under U.S. GAAP and IFRS. The difference representing an amount of €7 million has been accounted for as a financial loss in the U.S. GAAP statement of income.

**Contribution of Space businesses by Alcatel and Alenia to two jointly controlled joint ventures**

As described in Note 3 to the financial statements, on July 1, 2005, Alcatel and Finmeccanica announced the creation of two joint ventures that had been described in a memorandum of understanding signed by the parties on June 24, 2004: Alcatel Alenia Space (Alcatel holds 67% and Finmeccanica 33%) and Telespazio Holding (Finmeccanica holds 67% and Alcatel 33%). These joint ventures are jointly controlled, as defined by IAS 31 *Joint Ventures* and are therefore consolidated using the proportionate method of consolidation starting July 1, 2005.

Under IFRS, in accordance with the guidance provided by SIC 13 *Jointly Controlled Entities — Non-Monetary Contributions by Venturers*, the recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. Therefore a gain related to the contributed business was accounted for amounting to €129 million as of December 31, 2005.

Under U.S. GAAP, contributing assets to a joint venture does not usually result in the culmination of the earnings process. However, similar to the guidance in Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*, when cash is paid to one of the joint venturers in order to balance the fair market value of assets contributed by each venturer, gain recognition is allowed insofar as such gain is limited to the lesser of the computed gain or the amount of cash received, provided the recipient has no refund or continuing support obligation. As indicated in Note 3, Alcatel received from Finmeccanica a payment of €109 million upon creation of the joint venture.

Further, the gain on contributed assets differs under U.S. GAAP from the gain accounted for under IFRS due to differences between the net book value of the contributed assets under both standards, mainly related to the amortization of goodwill (see Note 38b) and accounting treatment of pensions (see Note 38f). As a consequence of the above, the gain related to the contributed business accounted for under U.S. GAAP in 2005 amounts to €72 million.

**(b) Amortization and impairment of goodwill**

Under French GAAP, goodwill was generally amortized over its estimated life, not exceeding 20 years.

As business combinations consummated before January 1, 2004 were not restated in the opening IFRS balance sheet, accumulated amortization of goodwill as of December 31, 2004 accounted for in accordance with French GAAP was maintained in the IFRS consolidated financial statements.

From January 1, 2004 goodwill (including goodwill on equity method investments) are no longer amortized under IFRS but annually tested for impairment as prescribed by IFRS 3.

Beginning January 1, 2002, for the purpose of preparing the U.S. GAAP reconciliation, Alcatel adopted SFAS No. 142 *Goodwill and Other Intangible Assets* ("SFAS 142"). Goodwill is no longer amortized but rather tested for impairment at the adoption date and on an annual basis or whenever indicators of impairment arise. The goodwill impairment test, which is based on fair value, is performed at the reporting unit level (one level below the operating segment). In the first step, the fair value of the reporting unit is compared to its book value, including goodwill. If the fair value of the reporting unit is less than its book value, a second step is performed which compares the implied value of the reporting unit's goodwill to the carrying value of its goodwill. The implied value of the goodwill is determined based upon the difference between the fair value of the division and the net of the fair value of the identifiable assets and liabilities of the reporting unit. If the implied value of the goodwill is less than its carrying value, the difference is recorded as an impairment. During 2002, material impairment losses were accounted for in accordance with SFAS 142 requirements. These impairments losses were related to some of the business combinations accounted for using French "pooling of interests" method described in Note 38a above.

Under IFRS, goodwill is allocated to "cash generating units" (defined as the smallest group of identifiable assets that generates cash inflows from continuing use largely independent of the cash inflows from other assets) or groups of "cash generating units", which represent the lowest level within the entity at which the goodwill is monitored for internal management purposes. In Alcatel-Lucent this level is similar to the reporting unit level as defined by SFAS 142. If the recoverable amount of the Group of cash generating units (including goodwill) is lower than its carrying amount, an impairment loss shall be accounted for to reduce the carrying amount of the assets of the Group of units to the recoverable amount, first in reducing the carrying amount of goodwill and then in reducing the carrying amounts of other assets.

The impairment losses accounted for under U.S. GAAP, mainly in 2002, were not accounted for under IFRS, as these impairment losses were partially related to business combinations in which no goodwill had been recorded under IFRS as indicated in Note 38a.

As prescribed by paragraph 36 of SFAS 142 "When an entity reorganizes its reporting structure in a manner that changes the composition of one or more of its reporting units, the guidance in paragraphs 32 and 33 shall be used to reassign assets and liabilities to the reporting units affected. However, goodwill shall be reassigned to the reporting units affected using a relative fair value allocation approach."

The reorganization of the reporting structure that occurred following the merger of historical Alcatel with Lucent by itself did not require a specific goodwill impairment test. However, we have considered that an impairment test should be re-performed at year end under U.S. GAAP due to the adoption of a new reporting structure as under IFRS. Following this impairment test, no impairment has been accounted for under IFRS as under U.S. GAAP.

Additionally, goodwill on equity method investments is no longer amortized. However, it is still to be tested for impairment in accordance with Accounting Principles Board Opinion ("APB") No. 18 *The Equity Method of Accounting for Investments in Common Stock* ("APB 18").

Amortization charges of goodwill for fiscal year 2002 and 2003 accounted for in our previous French GAAP consolidated financial statements are therefore restated in our U.S. GAAP consolidated financial statements and specific U.S. GAAP impairment losses have been accounted for related to business combinations recorded under French "pooling of interest methods" that were not restated under IFRS.

### **(c) Capitalization of development expenses related to Research and development efforts**

Under IFRS IAS 38 *Intangible assets* ("IAS 38"), expenses related to development phase of a research and development project shall be capitalized if certain criteria are met:

- technical feasibility of completing the project so that it will be available for use or sale;
- intention to complete the project;
- ability to use or sell the intangible asset arising from the project,;
- capacity to generate probable future economic benefits;
- availability of adequate resources to complete the development; and
- ability to measure the expenditures attributable to the project.

Under U.S. GAAP, software development costs would be similarly capitalized in accordance with SFAS No. 86 *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*. However, in accordance with SFAS No. 2 *Accounting for Research and Development Costs* all other development costs shall be charged to expense when incurred.

### **(d) Liability recognition for certain employee termination benefits and other costs associated to restructuring plans such as anticipated termination of leases**

The main difference between IFRS and U.S. GAAP relates to voluntary termination benefits. Under IAS 19 *Employee benefits* ("IAS 19"), benefits are recognized when the entity is demonstrably committed to providing those benefits. This definition differs from the requirements of SFAS No. 88 *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, the liability is recognized when incurred (when the employee accepts the entity's offer of voluntary termination of employment).

Another difference is related to the accounting method for onerous contracts. Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* ("IAS 37"), an onerous contract is a contract in which the unavoidable costs of meeting its obligations exceed the economic benefits expected. We recognize the provisions as soon as it is determined that the costs will exceed the expected economic benefits. In the specific case of onerous operating lease the provision could be recognized before we cease to use the asset concerned. Under SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS 146"), a liability for a cost to terminate a contract before the end of its term shall be recognized at fair value when the entity terminates the contract. If the contract is an operating lease, the fair value of the liability shall be accounted for at the cease-use date.

In the context of a business combination, under IFRS, restructuring provisions are recognized as part of the acquired liabilities only if the acquiree has an existing liability at the acquisition date for a restructuring recognized in accordance with IAS 37. Under U.S. GAAP, and in accordance with EITF Issue 95-3 *Recognition of Liabilities in Connection with a Purchase Business Combination* ("EITF 95-3"), certain restructuring provisions of an acquiree may be recognized at the acquisition date if the following specific criteria are met. As of the acquisition date, management with the appropriate level of authority begins to assess and formulate a restructuring plan and such plan is completed as soon as possible after the acquisition date but no later than one year from the acquisition date. Also, the plan must specifically identify all required actions to be completed in sufficient detail by location and function and the actions required by such plan need to begin as soon as possible after the plan is finalized, and the period of time to complete the plan indicates that significant changes to the plan are not likely.

As of December 31, 2006, in accordance with EITF 95-3, no restructuring provision was recognized under U.S. GAAP as of the acquisition date, as some of the specific conditions defined by EITF 95-3 were not met. Particularly the condition related to the completeness of the assessment of which employees of Lucent will be involuntary terminated or relocated and the approval and commitment of Alcatel-Lucent to the different plans which are envisaged, were absent.

To the extent that the costs do not meet the criteria of EITF 95-3, the costs will be expensed in the period incurred. However, because of the nature of the integration plans and its estimated costs, it is not possible to provide an estimate of the costs that will be reported as expenses in the future.

Prior to the consummation of the merger with Alcatel, Lucent had previously recognized certain severance liabilities under on-going benefit arrangements related to past services and accumulated, were likely to be paid and were reasonably estimated. These liabilities were eliminated in the purchase price allocation under IFRS and U.S. GAAP as they could no longer be reasonably estimated due to the merger and related restructuring actions contemplated to occur over time.

**(e) Other comprehensive income**

SFAS No. 130 *Reporting Comprehensive Income* ("SFAS 130") requires retroactive reporting of comprehensive income and its components, displayed as prominently as other financial statements. Comprehensive income may be defined for U.S. GAAP purposes as the change in equity of a business enterprise from transactions and other events and circumstances from non-owner sources.

**(f) Pension and post-retirement benefits other than pension plans**

Prior to December 31, 2006, under U.S. GAAP, when the unfunded accumulated benefit obligation ("ABO") (being the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to that date and based on current and past compensation levels) exceeds the fair value of plan assets, an additional minimum liability must be recognized in accordance with SFAS No. 87 *Employers' Accounting for Pensions*. If this liability exceeds the unrecognized prior service cost, the excess is recorded as a reduction of shareholders' equity. Under IFRS (IAS 19), there is no such requirement.

Starting January 1, 2004, Alcatel has complied with IAS 19 (Employee Benefits). As a result, the actuarial gains and losses linked to experience adjustments and to the effects of changes in actuarial assumptions that existed at January 1, 2004, were recorded in shareholders' equity (see Note 1k). Under U.S. GAAP those actuarial gains and losses will be recognized over the expected average remaining working lives of the employees.

Similar differences exist for post-retirement benefits other than pensions granted to employees, primarily life insurance and health care, except that there is no requirement to recognize a minimum liability adjustment under SFAS No. 106 "Employers' Accounting for Post-retirement Benefits other than Pensions".

SFAS No. 158 *Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans* ("SFAS 158") was adopted on December 31, 2006 as required for U.S. GAAP purposes. SFAS 158 requires, among other things, the recognition of the funded status of each defined pension benefit plan, retiree health care and other post-retirement benefit plans and postemployment benefit plans on the balance sheet. Each overfunded plan is recognized as an asset and each underfunded plan is recognized as a liability. The initial impact of the standard due to unrecognized prior service costs or credits and net actuarial gains or losses as well as subsequent changes in the funded status is recognized as a component of accumulated comprehensive loss in shareholders' equity. Additional minimum liabilities and related intangible assets are also derecognized upon adoption of the new standard. Under IFRS, there is no such requirement.

Under IFRS, the amount of prepaid pension costs that can be recognized in the financial statements is limited to the sum of the cumulative unrecognized net actuarial losses and past service costs, the present value of available refunds from the benefit plans and reductions in future contributions to the plans. These limitations do not apply under U.S. GAAP.

**(g) Share-based payment**

Accounting for stock option plans under IFRS *Share-Based Payment* ("IFRS 2") leads to recognition of a compensation expense. Equity-settled share based payments such as stock options plans are measured at fair value. Fair value is determined at the date of grant using an appropriate evaluation model (see Note 1w and Note 23e). Only options issued after November 7, 2002 and not fully vested at January 1, 2005 are accounted for using IFRS principles. Other stock options granted did not lead to recognition of a compensation expense.

Under U.S. GAAP, until January 1, 2006, Alcatel accounted for those plans under the recognition and measurement principles of APB Opinion No. 25 *Accounting For Stock Issued To Employees* ("APB 25"), and related interpretations. Stock-based employee compensation cost was reflected in net income based on the intrinsic value of the stock options granted.

Effective January 1, 2006, Alcatel adopted SFAS No 123(R) *Share Based Payment (Revised)* ("SFAS 123(R)"). Alcatel elected the modified prospective transition method, therefore, prior results were not restated. Under this method, SFAS 123(R) applies to new awards and to existing awards modified, repurchased, or cancelled after the required effective date (i.e. January 1, 2006 for Alcatel-Lucent).

Awards that were unvested as of the date of adoption of this standard, must be amortized prospectively as the respective service is rendered, and the cost of such awards will continue to be based on the grant date fair value as previously measured for the SFAS 123 disclosure requirements.

The effect on net income and earnings per share, if Alcatel had applied the fair value recognition provisions of SFAS No. 123 *Accounting for Stock-Based Compensation* ("SFAS 123"), is presented in Note 41(2).

There are different measurement dates used to determine the fair value of unvested share-based awards related to Lucent as of the acquisition date under IFRS and U.S. GAAP. As a result, the amount of compensation expense related to such awards will be different under IFRS and U.S. GAAP (see Note 38a).

Social charges, such as employers' payroll taxes arising from share-based compensation transactions are recognized over the same period as the related compensation charge under IFRS. Under U.S. GAAP, employers' payroll taxes are recognized on the exercise date for stock options or vesting dates for restricted stock.

**(h) Leases and sale-leaseback transactions**

SFAS No. 13 *Accounting for leases* ("SFAS 13") and SFAS No. 98 *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate* ("SFAS 98") require that in a sale-leaseback transaction with a lease classified as an operating lease, any profit or loss on the sale shall be deferred and amortized in proportion to the future rental payments over the period of time that the asset is expected to be used. Under IAS 17 *Leases*, the profit corresponding to the disposal of the asset is not deferred if the transaction was made with a selling price and rental payments that correspond to the market conditions at the time of the transaction.

IAS 17 and SFAS 13 prescribe similar lease accounting approaches based on whether a lease transfers substantially all of the risks and rewards related to ownership of the leased asset. However, SFAS 13 provides quantitative criteria to determine if a lease is an operating lease or a capital lease whereas IAS 17 requires subjective determinations to be made. As a result, in certain rare circumstances an operating lease under U.S. GAAP may be considered as finance lease under IAS 17 and vice versa.

**(i) Compound financial instruments**

If a financial instrument contains both a liability and an equity component, such components shall be classified separately as financial liabilities or equity instruments under IAS 32 *Financial Instruments: Disclosure and Presentation* ("IAS 32").

This is the case with the bonds issued by Alcatel in 2003 (Océane — Obligation Convertible ou Echangeable en Actions Nouvelles ou Existantes, bonds convertible into or exchanged for new or existing shares) and 2002 (ORANE — Obligation Remboursable en Actions Nouvelles ou Existantes, bonds mandatorily redeemable for new or existing shares) (see Note 1m). There was no debt component booked for the ORANE bonds since all interest was pre-paid at the issuance date. The ORANE bonds were entirely redeemed on December 23, 2005 in exchange for new shares.

These requirements differ from those of U.S. GAAP. The ORANE (notes mandatorily redeemable for shares) were presented on a specific balance sheet line item in the U.S. GAAP classified balance sheet as part of non-current liabilities and the OCEANE (bonds convertible into or exchanged for new or existing shares) are accounted for as financial debt and presented as long-term financial debt in the U.S. GAAP classified balance sheet (see Note 40(4)).

Other compound financial instruments were assumed in connection with the acquisition of Lucent. As a result, the fair value of these convertible debt securities included a separately identifiable fair value for the conversion features which was determined based on an independent valuation and considered as part of the purchase price and reflected as a component of equity under IFRS. The fair value of such conversion features was recognized as long-term debt under U.S. GAAP. The difference between the fair value of debt recognized at the acquisition date under IFRS and U.S. GAAP and the maturity amount is amortized as interest expense over the remaining contractual maturity periods.

In connection with a joint solicitation of consent from holders of Lucent's 2.875% Series A and Series B convertible debentures, Alcatel-Lucent provided a one-time adjustment to the conversion ratios for such securities as disclosed in Note 24 (c). The increase in the fair value of the conversion features was recognized as a non-cash €18 million charge under IFRS through income. Under U.S. GAAP, in accordance with EITF Issue 06-6 *Application of Issue No. 05-7*, the increase in the fair value of the conversion features was reflected as a reduction of the carrying amount of the debt and not in the results of operations. The reduction in the carrying amount of the debt instruments will be amortized as interest expense over the remaining contractual maturity periods of such securities.

**(j) Reversal of inventory write-down**

Under IAS 2 *Inventories* ("IAS 2"), inventories are written-down if the cost becomes higher than net realizable value. An assessment of the net realizable value is made at each reporting period. When there is clear evidence of an increase of the net realizable value because of changes in economic circumstances, the amount of the write-down is reversed even if the inventories remain unsold.

Under U.S. GAAP, ARB N°43 *Restatement and Revision of Accounting Research Bulletins* states that following a write-down "such reduced amount is to be considered the cost for subsequent accounting purposes" and it is therefore not permitted to be reversed before the inventory is either sold or written-off.

**(k) Presentation of consolidated financial statements**

The classification of certain items in, and the format of, Alcatel-Lucent's consolidated financial statements vary to some extent from U.S. GAAP. The most significant reporting and presentation practices followed by Alcatel-Lucent that differ from U.S. GAAP are described in the following paragraphs:

In its balance sheet, Alcatel-Lucent reports the costs incurred plus recognized profits less the sum of recognized losses and progress billings for all construction contracts in progress either in the specific balance sheet line item "amount due from customers" or in the specific line item "amounts due to customers" depending if the amounts determined contract by contract are respectively positive or negative as required by IAS 11 *Construction Contracts* ("IAS 11"). These specific balance sheet line items do not exist under U.S. GAAP and the corresponding amounts are presented in inventories, trade receivables and related accounts, or other reserves depending upon their nature.

Deferred taxes are presented in non current assets and liabilities under IFRS and as current or non current under U.S. GAAP based on the classification for financial reporting of the related tax asset or liability.

Under IFRS (IAS 1), the income statement is presented using a classification based on the function of expenses. Nevertheless, when an item of income and expense is material, the nature and amount shall be disclosed separately. Expenses presented on specific line item of the income statement due to their materiality are restructuring costs, impairment of intangible assets and gain on sale of stock in subsidiaries. Income statement line items presented could therefore differ between the two standards.

In its statement of cash flows under IFRS, Alcatel-Lucent presents the items "net cash provided (used) by operating activities before changes in working capital, interest and taxes". This item would not be shown under a U.S. GAAP statement of cash flows presentation.

## **(l) Discontinued operations**

In April 2004, Alcatel and TCL Communication Technology Holdings Limited announced the execution of a memorandum of understanding to form a joint venture mobile handset company. The joint venture company, which is an investment in associate in accordance with IAS 28 *Investments in Associates*, officially started operations on August 31, 2004 and is 55% owned by TCL and 45% owned by Alcatel and accounted for under the equity method. The mobile phone business of Alcatel is no longer considered to be under Alcatel's control as of December 31, 2003 and therefore the results of operations and financial position of this business have been accounted for in discontinued operations under IFRS in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* ("IFRS 5"). This transaction is not considered to be a discontinued activity under U.S. GAAP due to our continuing involvement (45% interest) in TCL & Alcatel Mobile Phone Ltd at year end (this concept being not present in the definition of discontinued operations in IFRS 5). As a result, the mobile phone business results from January 1, 2004 to August 30, 2004 have been presented as continued activities in our consolidated financial statements and not accounted for in the specific income (loss) from discontinued operation line item.

In May 2004, Alcatel announced that it had entered into a binding agreement with Draka to combine their respective global optical fiber and communication cable businesses. This transaction was completed on July 1, 2004. Draka owns 50.1% and Alcatel 49.9% of the new company Draka Comteq BV. The optical fiber business of Alcatel is no longer considered to be under Alcatel's control as of December 31, 2003 and therefore the results of operations and financial position of this business have been accounted for in discontinued operations under IFRS. This transaction does not qualify for discontinued operations reporting under U.S. GAAP due to our 49.9% interest in Draka Comteq BV at year end. Under U.S. GAAP, the optical fiber business results from January 1, 2004 to June 30, 2004 have been presented as continued activities in our consolidated financial statements and not accounted for in the specific income (loss) from discontinued operation line item.

On April 5, 2006, Alcatel announced that the Board of Directors of Thales had approved the acquisition in principle of Alcatel's satellite subsidiaries, its railway signaling business and its integration and services activities for mission-critical systems not dedicated to operators or suppliers of telecommunications services. On December 4, 2006, Alcatel-Lucent and Thales announced that they had signed a final agreement. The transaction primarily consisted of the contribution and disposal by Alcatel-Lucent to Thales of certain assets as disclosed in Note 3. This transaction does not qualify for discontinued operations reporting under U.S. GAAP due to our continuing 20.95% interest in Thales once the transaction will be completed. Under U.S. GAAP, the results of the businesses to be disposed of or contributed to Thales from January 1, 2004 to December 31, 2006 have been presented as continued activities in our consolidated financial statements and not accounted for in the specific income (loss) from discontinued operation line item. Assets and liabilities have been accounted for as disposal groups in the balance sheet under both accounting standards.

Due to differences in accounting for goodwill, the value of net assets under IFRS and U.S. GAAP is different with regard to the discontinued operations of SAFT and Saft Power Systems (see comments given in Note 3 — Changes in consolidated companies of our consolidated financial statements under IFRS). As a result, we have recorded a reconciling charge of €35 million before tax in our income (loss) from discontinued activities under U.S. GAAP in 2004.

## **(m) Effect of cumulative translation adjustments on sale of subsidiaries**

We elected to reset the cumulative translation adjustments to zero as of transition date to IFRS (January 1, 2004), as discussed in Note 1(d) to our consolidated financial statements. As a result, we created a permanent reconciling item between IFRS and U.S. GAAP. A portion of this reconciling item is reversed each time we dispose of a consolidated subsidiary, the financial statements of which were denominated in a currency other than our reporting currency, the euro, and for which the cumulative translation adjustment as of January 1, 2004 was something other than zero under U.S. GAAP.

## **(n) Adjustments on equity affiliates**

The most significant portion of this adjustment is related to the share in net assets of Thales, which is accounted for under the equity method. The difference primarily arose from the following:

Our adoption of SFAS 142, effective January 1, 2002, which required us to cease the amortization of goodwill (including goodwill related to equity affiliates) for U.S. GAAP purposes. Effective upon our transition to IFRS (January 1, 2004), we discontinued amortization of goodwill in accordance with IFRS 3; however, we adopted the IFRS 1 transitional provisions on a prospective basis. This difference in the adoption dates between the two standards has created a reconciling item which is presented as "Adjustments on equity affiliates" as it relates to "Share in net assets of equity affiliates" balance sheet line item.

Thales, a French public company, also adopted IFRS effective January 1, 2004. The primary reconciling item between French GAAP and IFRS resulted from the election of the option to record accumulated unrecognized actuarial gains and losses relating to pensions at the transition date in shareholders' equity pursuant to IFRS 1. As a result, an adjustment has been recorded to cancel the effect of these IFRS transitional provisions in arriving at U.S. GAAP net income.

Another reconciling item is related to the impact in Thales of the adoption of SFAS 158 as described in Note 38f above.

**(o) Fair value of marketable securities and other financial assets**

During the transition to IFRS, we decided to designate as "financial assets at fair value through profit or loss" some of the financial assets reported as "marketable securities", as permitted by the provisions of IAS 39 § 9(b), which relate to the definitions of the four categories of financial instruments, and in particular, for financial assets with quoted market prices in an active market and the fair value of which can be reliably measured.

Under U.S. GAAP, these marketable securities are classified as "available-for-sale" securities according to the guidance provided by SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* with change in fair value recorded in "Other Comprehensive Income".

Under IFRS financial assets classified as available for sale are measured at fair value consistent with U.S. GAAP. Paragraph 48A of IAS 39 indicates that "the best evidence of fair value is quoted prices in an active market. If the market (...) is not active, an entity establishes fair value by using a valuation technique". As indicated in paragraph AG80 of IAS 39: "the fair value of investments in equity instruments that do not have a quoted market price in an active market (...) is reliably measurable if (a) the variability of the range of reasonable fair value estimates is not significant for the instrument, or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value."

Under U.S. GAAP, the fair value of an equity instrument is readily determinable if sales prices or bid-and-ask quotations are currently available on a securities exchange market, provided that those prices or quotations are publicly reported. The difference between the definition of a fair value readily determinable between the two sets of accounting standards can lead to recognize some financial assets at fair value under IFRS and at cost under U.S. GAAP.

**Note 39 – Reconciliation to U.S. GAAP**

The following is a summary of the estimated adjustments to Alcatel-Lucent net income (loss) attributable to the equity holders of the parent for the years 2006, 2005 and 2004 and Alcatel-Lucent shareholders' equity attributable to the equity holders of the parent at December 31, 2006, 2005 and 2004, which would be required if U.S. GAAP had been applied instead of IFRS.

[Back to Contents](#)**(1) Net income**

(in millions)	Note	2006 <sup>(1)</sup>	2006	2005	2004
<b>Net income (loss) attributable to the equity holders of the parent according to IFRS</b>		<b>\$(232)</b>	<b>€(176)</b>	<b>€930</b>	<b>€576</b>
Business combinations and amortization of goodwill	38(a)(b)	(532)	(403)	(100)	(43)
Capitalization of development costs	38(c)	52	39	23	73
Restructuring plans	38(d)	(61)	(47)	(52)	(97)
Sale and lease-back transactions	38(h)	(66)	(50)	(2)	23
Compound financial instruments	38(i)	52	39	(27)	(33)
Discontinued operations	38(l)	-	-	-	(35)
Share based payments	38(g)	(5)	(4)	69	60
Pension and post-retirement benefits	38(f)	80	61	(9)	30
Effect of cumulative transaction adjustments on sale of subsidiaries	38(m)	-	-	34	-
Reversal of inventory write-downs	38(j)	4	3	-	(25)
Fair value of marketable securities	38(o)	-	-	(21)	-
Adjustment on equity affiliates	38(n)	(14)	(10)	(3)	(3)
Other adjustments		(12)	(9)	(14)	(4)
Tax effect		(44)	(33)	(65)	28
<b>Net income (loss) according to U.S. GAAP</b>		<b>\$(780)</b>	<b>€(590)</b>	<b>€763</b>	<b>€550</b>

(1) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 1 = \$1.3197 on December 31, 2006.

**(2) Shareholders' equity**

(in millions)	Note	December 31, 2006 <sup>(1)</sup>	December 31, 2006	December 31, 2005	December 31, 2004
<b>Shareholders' equity attributable to the equity holders of the parent according to IFRS</b>		<b>\$20,446</b>	<b>€15,493</b>	<b>€6,227</b>	<b>€4,913</b>
Business combinations and amortization of goodwill	38 (a)(b)	5,850	4,433	3,265	3,107
Capitalization of development costs	38 (c)	(192)	(146)	(194)	(224)
Restructuring plans	38 (d)	16	12	60	109
Sale and lease-back transactions	38 (h)	(323)	(245)	(195)	(193)
Compound financial instruments	38 (i)	(1,109)	(840)	(116)	(734)
Pension and post-retirement benefits	38 (f)	1,105	837	(420)	(287)
Discontinued operations	38 (l)	-	-	-	3
Reversal of inventory write-downs	38 (j)	(28)	(21)	(25)	(25)
Adjustment on equity affiliates	38 (n)	24	18	100	101
Other adjustments		7	5	17	48
Tax effect		(346)	(262)	-	46
<b>Shareholders' equity according to U.S. GAAP</b>		<b>\$25,450</b>	<b>€19,284</b>	<b>€8,719</b>	<b>€6,864</b>

(1) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 1 = \$1.3197 on December 31, 2006.

[Back to Contents](#)**Note 40 – Summarized U.S. GAAP Consolidated Financial Statements**

Under U.S. GAAP, the following information would be set forth in the consolidated financial statements for the years ended December 31, 2006, 2005 and 2004 as either a separate statement or as a component of the consolidated statements of changes in shareholder's equity and minority interests.

**(1) Summarized U.S. GAAP Consolidated Income Statements**

(in millions)	2006 <sup>(1)</sup>	2006	2005	2004
<b>Net sales</b>	<b>\$18,978</b>	<b>€14,381</b>	<b>€13,129</b>	<b>€ 12,663</b>
Cost of sales	(13,167)	(9,978)	(8,517)	(8,092)
Administrative and selling expenses	(2,841)	(2,152)	(2,049)	(2,004)
Research and development expenses	(2,311)	(1,751)	(1,439)	(1,573)
Purchased in-process R&D	(613)	(465)	(10)	(9)
Restructuring costs	(682)	(517)	(174)	(431)
Amortization and impairment of goodwill and other operating expenses	(636)	(482)	940	550
<b>Income (loss) from operations</b>	<b>-</b>	<b>-</b>	<b>(40)</b>	<b>(44)</b>
Interest expense on notes mandatorily redeemable for shares	(293)	(222)	(203)	(191)
Other interest expense	79	60	114	128
Interest income and other financial income, net	63	48	165	221
Gain on sale of stock in subsidiaries	(787)	(596)	976	664
<b>Income (loss) from continuing operations before taxes</b>	<b>15</b>	<b>12</b>	<b>(22)</b>	<b>(33)</b>
Share in net income of equity affiliates	54	42	(156)	(9)
Provision for income tax	(62)	(48)	(35)	(66)
Minority interests	(780)	(590)	763	556
<b>Net income (loss) from continuing operations</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(6)</b>
Income (loss) from discontinued operations	\$ (780)	€ (590)	€ 763	€ 550
<b>Net income (loss)</b>	<b>\$ (780)</b>	<b>€ (590)</b>	<b>€ 763</b>	<b>€ 550</b>

(1) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of €1 = \$1.3197 on December 31, 2006.

**(2) Earnings per Share under U.S. GAAP**

Earnings per share presented below are calculated in accordance with SFAS 128 *Earnings per Share*. The number of shares to be issued upon conversion of notes mandatorily redeemable for new or existing shares (ORANE) is excluded of the calculation of basic earnings per share.

	2006 <sup>(1)</sup>	2006	2005	2004
Ordinary shares				
<b>Basic earnings per share:</b>				
Net income (loss) before cumulative effect of adoption of new standards	\$(0.54)	€(0.41)	€0.56	€0.45
Net income (loss)	\$(0.54)	€(0.41)	€0.56	€0.45
<b>Diluted earnings per share:</b>				
Net income (loss) before cumulative effect of adoption of new accounting standards	\$(0.54)	€(0.41)	€0.55	€0.42
Net income (loss)	\$(0.54)	€(0.41)	€0.55	€0.42

(1) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of €1 = \$1.3197 on December 31, 2006.

The following tables present a reconciliation of the basic earnings per share and diluted earnings per share for each year disclosed.

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2006		Ordinary shares	
	Net income (loss)	Number of shares	Per share amount
<i>(in millions of euros)</i>			
Basic earnings per share	(590)	1,449,000,656	€ (0.41)
Stock option plans			
Convertible bonds and notes mandatorily redeemable for shares	—	—	—
Diluted earnings per share	(590)	1,449,000,656	€ (0.41)

The number of stock options not exercised as of December 31, 2006 amounted to 192,759,306 shares. These shares, subject to issuance in the future, have not been taken into account for the calculation of the diluted earnings per share, due to their anti-dilutive effect.

The following table summarizes the number of potential ordinary shares that were excluded from the diluted per share calculation, because the effect of including these potential shares was anti-dilutive:

Alcatel-Lucent's convertible bonds (OCEANE) issued on June 12, 2003	63,192,019
8% convertible securities <sup>(1)</sup>	3,067,982
7.75% convertible securities <sup>(1)</sup>	3,705,372
2.75% Series A convertible securities <sup>(1)</sup>	4,727,274
2.75% Series B convertible securities <sup>(1)</sup>	5,552,971

(1) Number of potential ordinary shares related to the convertible securities instrument derived from the Lucent acquisition are computed on a pro rata basis.

2005		Ordinary shares	
	Net income (loss)	Number of shares	Per share amount
<i>(in millions of euros)</i>			
Basic earnings per share	763	1,367,994,653	€ 0.56
Stock option plans	—	9,188,929	—
Convertible bonds and notes mandatorily redeemable for shares	—	—	—
Diluted earnings per share	763	1,377,183,582	€ 0.55

The number of stock options not exercised as of December 31, 2005 amounted to 149,359,801 shares. Only 9,188,929 share equivalents have been taken into account for the calculation of the diluted earnings per share, as the remaining share equivalents had an anti-dilutive effect.

Furthermore, 63,192,019 new or existing Alcatel ordinary shares, which are issuable in respect of historical Alcatel's convertible bonds (OCEANE) issued on June 12, 2003, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

2004	Net income (loss)	Ordinary shares Number of shares	Per share amount
<i>(in millions of euros)</i>			
Basic earnings per share	550	1,228,745,770	€0.45
Stock option plans	—	14,133,029	—
Notes mandatorily redeemable for shares (ORANE)	29	120,782,388	—
Diluted earnings per share	579	1,363,661,187	€ 0.42

The number of stock options not exercised as of December 31, 2004 amounted to 150,715,229 shares. Only 14,133,029 share equivalents have been taken into account for the calculation of the diluted earnings per share, as the remaining share equivalents had an anti-dilutive effect.

Furthermore, 63,192,019 new or existing Alcatel ordinary shares, which are issuable in respect of historical Alcatel's convertible bonds (OCEANE) issued on June 12, 2003, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

[Back to Contents](#)**(3) Statements of Comprehensive Income**

Under U.S. GAAP, the following information would be set forth in the consolidated financial statements for the years ended December 31, 2006, 2005 and 2004 as either a separate statement or as a component of the consolidated statement of changes in shareholders' equity and minority interests.

(in millions)	2006 <sup>(1)</sup>	2006	2005	2004
<b>Net income (loss) under U.S. GAAP</b>	<b>\$ (780)</b>	<b>€ (590)</b>	<b>€ 763</b>	<b>€ 550</b>
Other comprehensive income:				
— Foreign currency translation adjustments	(649)	(492)	562	(262)
— Unrealized gains (losses) on securities	37	28	(48)	39
— Cash flow hedge	(5)	(4)	2	—
— Minimum pension liability adjustments net of tax	244	185	(138)	(119)
— Unrecognized actuarial gains and losses and prior service costs net of tax	1,050	795	—	—
<b>Comprehensive income (loss) according to U.S. GAAP</b>	<b>\$ (103)</b>	<b>€ (78)</b>	<b>€ 1,141</b>	<b>€ 208</b>

(1) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 1 = \$1.3197 on December 31, 2006.

If Alcatel-Lucent were to present consolidated financial statements in accordance with U.S. GAAP, the accumulated balances for minimum pension liability adjustments, unrecognized actuarial gains and losses and prior service costs, foreign currency translation adjustments, unrealized gains (losses) on available-for-sale securities and cash flow hedge would be disclosed either on the face of the consolidated balance sheets, in the statements of changes in shareholders' equity and minority interests, or in the notes to the financial statements. The following table presents the accumulated balances, net of tax, of each of these classifications.

(in millions of euros)	Minimum pension liability adjustments	Unrecognized actuarial gains and losses and prior service costs	Foreign currency translation adjustments	Unrealized gains (losses) on securities	Cash flow Hedge
<b>2006</b>					
Balance beginning of the year	(501)	—	(554)	34	2
Current period change	185	—	(492)	28	(4)
Adoption of SFAS 158	316	479	—	—	—
Balance end of the year	—	479	(1,046)	62	(2)
<b>2005</b>					
Balance beginning of the year	(363)	—	(1,116)	82	—
Current period change	(138)	—	562	(48)	2
Balance end of the year	(501)	—	(554)	34	2
<b>2004</b>					
Balance beginning of the year	(244)	—	(854)	43	—
Current period change	(119)	—	(262)	39	—
Balance end of the year	(363)	—	(1,116)	82	—

[Back to Contents](#)**(4) Classified Balance Sheet as of December 31:***(in millions of euros)*

	2006	2005	2004
<b>ASSETS</b>			
Cash and cash equivalents	4,749	4,510	4,611
Marketable securities	1,245	640	552
Other debtors	1,739	1,310	1,894
Trade receivables and related accounts	4,175	4,090	3,494
Inventories, net	2,351	1,695	1,502
Assets held for sale	2,227	50	118
<b>Total current assets</b>	<b>16,486</b>	<b>12,295</b>	<b>12,171</b>
Marketable securities	697	-	-
Other investments & other non current assets, net	2,281	2,236	2,335
Prepaid pension costs	5,334	76	61
Share in net assets of equity affiliates	700	706	708
<b>Investments and other non-current assets</b>	<b>9,012</b>	<b>3,018</b>	<b>3,104</b>
<b>Property, plant and equipment net</b>	<b>2,070</b>	<b>1,168</b>	<b>1,218</b>
Acquisition goodwill, net	13,252	7,024	6,829
Other intangible assets, net	4,823	679	566
<b>Intangible assets, net</b>	<b>18,075</b>	<b>7,703</b>	<b>7,395</b>
<b>Total non-current assets</b>	<b>29,157</b>	<b>11,889</b>	<b>11,717</b>
<b>Total assets</b>	<b>45,643</b>	<b>24,184</b>	<b>23,888</b>

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<i>(in millions of euros)</i>	2006	2005	2004
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Other current liabilities	1,706	2,106	2,553
Trade payables and related accounts	4,022	3,755	3,356
Accrued contract costs & other accrued liabilities	2,386	1,264	1,573
Customers deposits and advances	778	1,144	1,164
Short-term financial debt	1,196	1,051	1,053
Liabilities related to discontinued activities or to a disposal group held for sale	1,596	-	100
<b>Total current liabilities</b>	<b>11,684</b>	<b>9,320</b>	<b>9,799</b>
Notes mandatorily redeemable for shares <sup>(1)</sup>	-	-	645
<b>Other long-term liabilities</b>	<b>2,398</b>	<b>573</b>	<b>381</b>
Other long-term financial debt	214	394	388
Bonds and notes issued, long-term	5,674	2,519	3,240
<b>Long-term financial debt</b>	<b>5,888</b>	<b>2,913</b>	<b>3,628</b>
Other reserves	758	470	639
Accrued pensions and retirement obligations	5,134	1,717	1,557
<b>Total reserves</b>	<b>5,892</b>	<b>2,187</b>	<b>2,196</b>
<b>Total non-current liabilities</b>	<b>14,178</b>	<b>5,673</b>	<b>6,850</b>
<b>MINORITY INTERESTS</b>	<b>497</b>	<b>472</b>	<b>375</b>
Capital stock	4,619	2,857	2,610
Additional paid-in capital	30,755	21,594	21,215
Retained earnings, fair value and other reserves	(13,451)	(13,558)	(14,241)
Unrealized holding gains (losses) and cash flow hedge	60	36	82
Cumulative translation adjustments	(1,046)	(554)	(1,116)
Less treasury stock, at cost	(1,653)	(1,656)	(1,686)
<b>SHAREHOLDERS' EQUITY</b>	<b>19,284</b>	<b>8,719</b>	<b>6,864</b>
<b>Total liabilities and shareholders' equity</b>	<b>45,643</b>	<b>24,184</b>	<b>23,888</b>

<sup>(1)</sup> The notes mandatorily redeemable for shares previously reflected between the total non-current liabilities and the minority interests captions have been reclassified within the caption total non-current liabilities.

[Back to Contents](#)**(5) Statements of Changes in Shareholders' Equity***(in millions of euros)*

	Capital stock	Additional paid-in capital	Retained earnings	Minimum liability adjustment	Unrecognized gains and losses and prior service costs	Unrealized holding gains/(losses)	Cash flow hedge	Cumulative translation adjustment	Treasury Stock at cost	Net income (loss)	Shareholders' equity
<b>Balance at December 31, 2004 after appropriation</b>	<b>2,610</b>	<b>21,215</b>	<b>(13,878)</b>	<b>(363)</b>	<b>-</b>	<b>82</b>	<b>-</b>	<b>(1,116)</b>	<b>(1,686)</b>	<b>-</b>	<b>6,864</b>
Capital increase	5	13									18
Capital increase linked to the repayment of the notes mandatorily redeemable for shares (ORANE)	242	403									645
Net change in treasury stock Ordinary shares owned by consolidated subsidiaries		(37)							30		(7)
Net changes in cash flow hedge							2				2
Net changes in unrealized holding gains/(losses)						(48)					(48)
Minimum liability adjustment				(138)							(138)
Translation adjustment								562			562
Other changes			58								58
Net income (loss)			763								763
<b>Balance at December 31, 2005 after appropriation</b>	<b>2,857</b>	<b>21,594</b>	<b>(13,057)</b>	<b>(501)</b>	<b>-</b>	<b>34</b>	<b>2</b>	<b>(554)</b>	<b>(1,656)</b>	<b>-</b>	<b>8,719</b>
Acquisition of Lucent Technologies	1,756	8,806									10,562
Lucent's warrants		95									95
Lucent's outstanding stock options		164									164
Capital increase	6	14									20
Net change in treasury stock Ordinary shares owned by consolidated subsidiaries		(7)							3		(4)
Net changes in cash flow hedge							(4)				(4)
Net changes in unrealized holding gains/(losses)						28					28
Minimum liability adjustment				185							185
Unrecognized gains and losses and prior service costs				316	479						795
Translation adjustment								(492)			(492)
Deferred compensation		68									68
Dividends			(219)								(219)
Other changes		21	(64)								(43)
Net income (loss)										(590)	(590)
<b>Balance at December 31, 2006 before appropriation</b>	<b>4,619</b>	<b>30,755</b>	<b>(13,340)</b>	<b>-</b>	<b>479</b>	<b>62</b>	<b>(2)</b>	<b>(1,046)</b>	<b>(1,653)</b>	<b>(590)</b>	<b>19,284</b>
Proposed appropriation of net income (loss)			(960)							590	(370)
<b>Balance at December 31, 2006 after appropriation</b>	<b>4,619</b>	<b>30,755</b>	<b>(14,300)</b>	<b>-</b>	<b>479</b>	<b>62</b>	<b>(2)</b>	<b>(1,046)</b>	<b>(1,653)</b>	<b>-</b>	<b>18,914</b>

[Back to Contents](#)**Note 41 – Specific U.S. GAAP disclosures****(1) Impairment of goodwill (Disclosure SFAS 142) and purchase price allocation of Lucent**

The changes during 2006 in the carrying value of goodwill per segment are presented in the table below:

(In millions of euro)	Carrier Group	Enterprise Group	Service Group	Other	Total Group
<b>Balance as of December 1, 2004</b>	<b>4,170</b>	<b>709</b>	<b>799</b>	<b>1,153</b>	<b>6,831</b>
Goodwill acquired during year	154	29	29	–	212
Goodwill adjusted during allocation period	1	–	–	–	1
Impairment losses	–	–	–	(4)	(4)
Goodwill written off related to sale or discontinuance of business	–	–	–	(17)	(17)
Currency translation adjustments and other	(136)	34	(24)	–	(194)
<b>Balance as of December 31, 2004</b>	<b>4,189</b>	<b>704</b>	<b>804</b>	<b>1,132</b>	<b>6,829</b>
Goodwill acquired during year	25	–	4	111	140
Goodwill adjusted during allocation period	8	(6)	1	–	3
Goodwill written off related to sale or discontinuance of business	–	–	–	(343)	(343)
Currency translation adjustments and other	295	65	31	4	395
<b>Balance as of December 31, 2005</b>	<b>4,517</b>	<b>763</b>	<b>840</b>	<b>904</b>	<b>7,024</b>
Goodwill acquired during year <sup>(1)</sup>	11	29	–	7,391	7,431
Goodwill adjusted during allocation period	(9)	–	–	–	(9)
Impairment losses	(2)	–	–	–	(2)
Goodwill written off related to sale or discontinuance of business	(9)	–	(6)	(890)	(905)
Currency translation adjustments and other	(229)	(55)	(22)	19	(287)
<b>Balance as of December 31, 2006</b>	<b>4,279</b>	<b>737</b>	<b>812</b>	<b>7,424</b>	<b>13,252</b>

<sup>(1)</sup> The allocation of the goodwill generated by the Lucent acquisition has not yet been finalized (see Note 12).**Amortization of identifiable intangible assets acquired****Entities acquired during the year**

(In millions of euros)	Gross carrying amount	Accumulated amortization
<b>Amortized intangible assets</b>	<b>4,327</b>	<b>(456)</b>
— Acquired technology and in process research and development	3,078	(426)
— Other	1,249	(30)
<b>Unamortized intangible assets</b>	<b>502</b>	<b>–</b>

The amortization expense of entities acquired during the year was €61 million. In addition, a charge of €485 million was booked for write-off of IPR&D recognized through the Lucent and Nortel transaction. Amortization expense of intangible assets is expected to be €734 million in 2007, €529 million in 2008, €506 million in 2009, €506 million in 2010, €496 million in 2011, €403 million in 2012, €349 million in 2013, €296 million in 2014, €27 million in 2015 and €25 million in 2016.

**Alcatel-Lucent Group***(In millions of euros)*

	Gross carrying amount	Accumulated amortization
<b>Amortized intangible assets</b>	<b>5,957</b>	<b>(1,636)</b>
— Acquired technology	3,345	(668)
— Other	2,612	(968)
<b>Unamortized intangible assets</b>	<b>502</b>	<b>—</b>

The amortization expense for the year ended December 31, 2006 was €353 million. In addition, a charge of €465 million was booked for write-off of IPR&D recognized through the Lucent and Nortel transactions. Amortization expense of intangible assets is expected to €940 million in 2007, €673 million in 2008, €572 million in 2009, €519 million in 2010, €509 million in 2011, €409 million in 2012, €351 million in 2013, €296 million in 2014, €27 million in 2015 and €25 million in 2016.

The preliminary allocation of the Lucent's purchase price under U.S. GAAP is as follows:

The cost of the business combination is detailed in the following table:

Number of Lucent common shares outstanding as of November 30, 2006	4,498,666,060
Exchange ratio per share (1,952 Alcatel-Lucent ordinary shares exchanged for 10,000 Lucent ordinary shares tendered)	0.1952
<b>Total number of Alcatel-Lucent ordinary shares issued</b>	<b>878,139,615</b>
Multiplied by Alcatel-Lucent's stock price (in US\$) as of the announcement date	15.86
Fair value of Alcatel-Lucent ordinary shares issued (in millions of US\$)	13,927
Fair value of outstanding warrants	125
Fair value of outstanding stock-options and similar equity awards	291
Transaction costs (in millions of US\$)	53
<b>Cost of the business combination (in millions of US\$)</b>	<b>14,396</b>

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	Lucent's carrying amount	Fair value	Useful lives
Cash and cash equivalents and marketable securities	3,715	3,715	-
Property, plant and equipment	1,215	1,558	1-40 years
Goodwill	514	-	
Acquired technologies	352	3,614	5-10 years
In process research & development	-	581	5-7 years
Customer relationships - long term	-	1,239	5-8 years
Customer relationships - short term (backlog)	-	260	13 months
Trade names	-	661	Indefinite
Inventories	839	1,399	(1)
Trade and other receivables	1,003	1,003	-
Payables and advanced billings	(1,428)	(1,414)	-
Pensions, retirement indemnities and other post-retirement benefits	150	172	-
Bonds and notes issued	(5,129)	(5,096)	-
Provisions	(1,254)	(1,234)	-
Deferred taxes	121	(2,558)	-
Deferred compensation (unvested outstanding stock options)	-	75	-
Other assets and liabilities	187	399	-
<b>Net assets acquired</b>	<b>285</b>	<b>4,374</b>	<b>-</b>

*(1) Estimated liquidation period of the inventory step-up is 6 months.**Determination of the goodwill**(In millions of US\$)*

	Amount
Cost of the business combination (A)	14,396
Net assets acquired (B)	4,374
<b>Goodwill (A)-(B)</b>	<b>10,022</b>

**(2) Stock-based compensation (disclosure SFAS 123 and SFAS 148)**

From 1996 to 2006, Alcatel-Lucent adopted various stock option incentive plans (see Note 23).

The following information is disclosed according to SFAS 123R and are provided as a supplement to the IFRS disclosures provided in note 23.

The following table summarizes the classification of stock-based compensation expense under SFAS 123R:

	December 31, 2006
Cost of sales	20
Administrative and selling expenses	30
Research and development costs	18
<b>TOTAL</b>	<b>68</b>

The company did not record any tax benefit related to share based awards in 2006.

As of December 31, 2006, €106 million of unrecognized compensation cost related to unvested awards is expected to be recognized over a weighted-average period of 3.3 years.